UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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FINANCIAL GUARANTY INSURANCE COMPANY,

Plaintiff,

v. 12 CV 7372 (RWS)

THE PUTNAM ADVISORY COMPANY, LLC,

Defendant.

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November 20, 2013
12:05 p.m.

Before:

HON. ROBERT W. SWEET,

District Judge

APPEARANCES

QUINN EMANUEL URQUHART & SULLIVAN LLP
Attorneys for Plaintiff
BY: SEAN P. BALDWIN

MILBANK, TWEED, HADLEY & McCLOY
Attorneys for Defendant
BY: THOMAS A. ARENA

THE COURT: Financial Guarantee Against Putnam.

MR. ARENA: Good afternoon, your Honor, Thomas Arena of Milbank, Tweed, Hadley & McCloy for the defendant Putnam Advisory Company. We're here on a motion to dismiss the second amended complaint.

Your Honor, I have a binder of several exhibits that I may refer to during my oral argument. May I hand it up?

THE COURT: Pleased to have it. Thank you.

MR. ARENA: Your Honor, we're here on the motion to dismiss the second amended complaint that your Honor may recall in September of this year your Honor dismissed the first amended complaint filed by FGIC on two principal grounds.

With respect to FIGIC's fraud claim, your Honor dismissed that without prejudice for failure to plead loss causation.

With respect to FIGIC's negligence base claims, negligence and negligent misrepresentation, your Honor dismissed those claims for failure to plead the existence of a special relationship between FGIC and Putnam, the collateral manager of the Pyxis CDO at issue, sufficient to give rise on behalf of Putnam of a duty to disclose.

We don't believe, your Honor, that the very limited amendments that had been made to the second amended complaint fix those pleading defects.

In addition, your Honor, we believe that there is a separate and independent basis on which to dismiss the fraud claim, which is the failure to plead scienter.

I'm mindful of the fact, your Honor, that you have a room full of counsel, and I'm also mindful that we've argued this before. I'll try to be as telescoped as possible.

Let me start with loss causation, your Honor, just a couple of background facts as to what I believe the operative allegations are of the second amended complaint.

There is the Pyxis CDO, which closed in October of 2006. Putnam, my client, was the collateral manager for that CDO. The gravamen of the complaint is that there was an equity investor -- there were actually two equity investors, but ones at issue here. The two equity investors were Deutsche Bank and Magnetar. And the allegation is that Magnetar in fact controlled and directed Putnam's selection of assets for the collateral pool supporting the CDO; and that Magnetar did this because, in addition to having an equity interest in the deal, Magnetar was also shorting, taking the short counter position of some of this credit default swaps in the collateral pool. And so the allegation is, Putnam, you entered into this fraud, a billion dollar fraud, you selected collateral with the express design of causing this CDO to tank, it was a $1.5 billion CDO, and you did this to put money in the pocket of Magnetar.

With respect to loss causation, your Honor -- and just one other point about FGIC. FGIC is not a note holder. They're not a note holder. They didn't buy any notes. FGIC is here because FGIC issued a guaranty to Calyon. Who is Calyon? Calyon is the arranger of the CDO. Calyon is not a defendant in this case. But FGIC issued a guaranty to Calyon where the guaranty was supporting a credit default swap that FGIC subsidiary, also not a party to this lawsuit, had entered into with Calyon. And the credit default swap was essentially one where FIGIC's subsidiary was guaranteeing the performance of the Pyxis CDO itself. Putnam is not a party to that guaranty, it's not party to the credit default swap, FGIC is not a note holder.

So, loss causation. At the outset, FGIC argues, we don't even have to plead or prove loss causation because our fraud claim is based upon an instrument of insurance, and under Section 3105 of the New York State Insurance Code, we don't have to prove loss causation.

As your Honor held in your September decision dismissing the first amended complaint, that is not what the insurance code provides with respect to an entity that's a defendant like Putnam, which was not a party to the insurance contract. We think your Honor got it right back then. We think that's still the right analysis.

The one case that, the one case that FGIC appears to

rely upon, the principal reliance is a New York State case called MBIA versus Countrywide. And in that case, your Honor, while the Court held that you don't have to -- plaintiff does not have to prove loss causation where they are bringing a fraud claim based upon an instrument of insurance, the defendant in that case, unlike Putnam here, was a party to the insurance contract. Putnam received no proceeds under this guaranty. The suggestion that Putnam should be liable for rescissionary damages for a guaranty that FGIC entered into with another entity and that FGIC doesn't even have to prove that Putnam's alleged misstatements caused its loss, I would submit is unprecedented in New York State.

So I believe your Honor got it right, that Putnam -- that FGIC, excuse me, has to plead and prove loss causation.

The next line of defense that FGIC has thrown up is, well, our pleading is governed by 8(a), not 9(b) And I would refer your Honor to your decision in Cohen versus Stevanovich, 722 F. Supp. 2d, 416, I believe it's a 2010 decision. It's the last decision that I'm aware of in which your Honor has opined on this issue, where this Court clearly held that loss causation for fraud claims is governed by 9(b). Whether governed by 9(b) or 8(a), however, I would submit that FGIC has not adequately alleged loss causation, no matter -- under whatever standard is to be applied here.

As your Honor noted in your September decision of this

year in dismissing the first amended complaint, 91 percent of all U.S. issued CDOs had defaulted by the end of 2008. Pyxis 2006 is not a statistical outlier. And the test that your Honor put to FGIC, which I believe is the appropriate one, is you have to plead -- FGIC has to plead with particularity that there was some set of collateral that Putnam would have selected and intentionally didn't select because of Magnetar's alleged control, and had Putnam selected that other collateral, that this deal would not have defaulted. I don't believe that FGIC has adequately alleged that to be the case. I don't believe that FGIC can allege that to be the case.

Here's what FGIC alleges in their second amended complaint, the new allegations. First, painting with the broadest brush possible, FGIC alleges that all of the Magnetar CDOs -- and it alleges that there were 18, 18 Magnetar CDOs that were issued during 2006 -- Putnam is alleged to have been involved in only one. But the 18 Magnetar CDOs had all defaulted by 2012; whereas, in contrast, all of the other CDOs issued during 2006, only 72 percent had defaulted as of the end of 2012. And they suggest that this is an apples to apples comparison, and it proves that Magnetar's control somehow caused Pyxis to default and it would not have otherwise defaulted had Magnetar not had this alleged control. I would submit that this is not an apples to apples comparison. FGIC nowhere alleges that Pyxis or any of these other so-called

Magnetar CDOs had the same set of structural features, eligibility criteria, collateral quality tests, over collateralization levels, payment priorities, waterfall structures, as all of the other CDOs of which only 72 percent failed by 2012. I just think it's an apples to oranges comparison, and it just doesn't mean all that much where they have to allege loss causation.

They allege that if not for Magnetar's alleged involvement, Putnam would have selected better performing assets. I submit that this is totally speculative. There is no basis in the second amended complaint to show that but for Magnetar's involvement, Putnam intended to select some other asset.

And I would note, your Honor, and I'll get into this in more detail in a bit, this is not one of those cases where there are e-mails in which the collateral manager or the arranger refers to collateral in pejorative terms, pigs or the worst. We've all seen them. They've been in the press. This is not one of those cases. There are no allegations along those lines.

FGIC also argues, they have an analysis towards the end of their second amended complaint, that they've identified $167 million of assets, collateral assets purportedly selected by Magnetar that FGIC argues defaulted .35 of a year, four months, five months earlier than the rest of the collateral

assets in the Pyxis collateral pool.

I just want to take a step back for a second to consider this new allegation in light of FGIC's overall theory because it's totally inconsistent. FGIC's overall theory, which is set forth at paragraph four of the second amended complaint, is that Putnam seeded the entire collateral selection process to Magnetar; that Magnetar was the master puppeteer and FGIC just -- that Putnam just did Magnetar's bidding. I don't believe there is proof for that, but that's their core allegation.

So to go from there in paragraph four, which reads there is overwhelming evidence that the Pyxis collateral selection process was controlled and directed by Magnetar, to go from there to an analysis where FGIC says towards the end of their second amended complaint, well, we've isolated $167 million worth of collateral out of a $1.5 billion collateral pool, and we think we have evidence that Magnetar, or we're alleging that Magnetar directed Putnam to pick these assets. And we can show that these assets defaulted .35 of a year earlier than the rest, the other 90 percent of the collateral assets, and that somehow evidences loss causation. In addition to being incontinent with their principal theory, I would also submit that, if anything, this minor discrepancy in time, if anything, reinforces the conclusion that Putnam could not have chosen any assets consistent with the Pyxis eligibility

criteria and have avoided an event of default.

The Pyxis notes, your Honor, were set to mature in 2046. This was potentially a 40 year deal. The deal closed in 2006. The pyxis notes were scheduled -- they had a 40 year maturity.

Now, there's some variations on that. The notes could have been paid off early. But to suggest in light of a potential 40 year deal that some collateral assets, a small sliver, 10 percent or so defaulted .35 of a year earlier than the rest of the collateral assets, I submit is de minimis and does not show that there was any set of assets that Putnam could have selected consistent with the collateral, the collateral eligibility criteria and still avoided an event of default.

Let me turn then, your Honor, to scienter. I know your Honor did not rule on the sufficiency of the fraud claim with respect to scienter in your September decision, but I believe that there is a rock solid argument that the complaint, the second amended complaint does not adequately allege scienter, and that the fraud claim can be dismissed on that ground as well.

At the outset, there's also a dispute between the parties as to whether 8(a) or 9(b) governs. I recognize that 9(b) says that a defendant's intent and knowledge can be averred generally. But I also submit that the case law is

pretty clear that scienter is governed by the heightened pleading requirement of 9(b), in particular where there are allegations of alleged conscious misbehavior, the deliberate intentional misconduct that are being used to argue that as a basis for a defendant's scienter. And there's substantial authority to that effect, your Honor. There's Judge Sullivan's recent decision in Loreley versus Wells Fargo, there's Judge Baer's decision in Hammerstone, there's the Anwar case from this Court -- from this district, excuse me, which we also cite in our case, and there's other authority to that effect.

But let me get into their theory of scienter. So FGIC's theory, I submit, is neither plausible nor cogent whether you're applying 8(a) or 9(b). And what they're arguing is that Putnam engaged in a billion dollar plus fraud, risked its reputation and business, all to put millions of dollars in the pocket of -- not of Putnam, but of some third party that's not a defendant here, Magnetar.

What was Putnam getting out of this? Fees, collateral management fees; fees, which, under the operative collateral management agreement, could have been, could have been as high as $3 million a year. I believe those are customary fees in and of themselves. Case law is legion that mere desire to obtain customary fees for doing a transaction does not support a strong inference of scienter. But I mentioned that Putnam could have received $3 million a year as its fees, but it

didn't. It received far less. In fact, it received far less than customary fees. And if the mere receipt of customary fees can't support a strong inference of scienter, then the receipt of a small fraction of customary fees a fortiori can't support a strong inference of scienter.

And why did Putnam receive a fraction of its customary fees? Well, it goes to the structure of the fee arrangement that it had with the Pyxis CDO. And there were two aspects to cut to Putnam's fees. This was a senior fee and a subordinated fee. In total, they amounted to 20 basis points, 20 basis points applied against a $1.5 billion collateral pool. That's how you get to $3 million a year as to what Putnam could have earned.

However -- and this is set forth in the collateral management agreement which we've attached to our pleadings, and it's also set forth in the indenture which we've attached to our pleadings -- the senior fee was a 15 basis point fee. FGIC argues that fee was fixed. They say in their complaint, it's a fixed fee. It's anything but fixed. Because as set forth in the collateral management agreement and the indenture, the 15 base point fixed fee was to be applied against the monthly asset amount, the monthly value of the collateral, the notional value on the collateral assets, minus any defaulted securities.

So to the extent that Putnam, and as alleged by FGIC, picked collateral assets that it knew and had the intent would

fail and tank this deal, Putnam would not collect its 15 basis point fixed fee with respect to that defaulted security.

Now, is that a motive to commit a fraud? If the theory is you're doing all this to get your fee, by following through on the alleged fraud you're depriving yourself of getting the very fees that FGIC argues is your incentive for doing this deal. It's neither plausible nor cogent. Under 8(a) or 9(b) or any other analysis, it makes no sense. It collapses of its own weight. That's the fixed fee.

There's also a five basis point subordinate fee. It's referred to in FGIC's pleadings as an incentive fee. Here's how that worked. Not only was the five basis point subordinated fee subject to the monthly asset amount minus any defaulted security -- so subject to the same defect as the senior fee -- but the five basis point subordinated fee was also in the back of line under the priority of payments. And I will show you, your Honor, where that is. We make reference to it in our pleading, but it's set forth in the collateral management agreement and in the indenture.

So again, FGIC's theory. Putnam, at Magnetar's direction and control, you pick assets that you knew would fail and tank this deal. But if that's the case and Putnam was trying to cause this deal to default, Putnam's subordinated fee, five basis points, was at the back of the line. So if all the note holders and the equity holders didn't get paid, Putnam

wasn't getting paid its subordinated fee and in fact Putnam did not get paid its subordinated fee. Putnam stood to earn, if this deal worked smoothly, $3 million a year. Through the date of the filing of the initial complaint in this matter, Putnam -- it's alleged that Putnam received fees totaling 5.7 million. It could have made 18 million. It only received 5.7 million because this deal didn't perform well. Again, is that a motive to defraud or a motive not to commit fraud?

So that brings us, your Honor, to the issue of conscious misbehavior. And the law is clear that where there are allegations of motive are weak or are nonexistent, under the law conscious misbehavior has to be pleaded at a correspondingly greater level. In Judge Baer's language in Hammerstone, there has to be pleading of, quote, deliberate illegal conduct, deliberate illegal conduct. The second amended complaint, like the first amended complaint, referred to a number of e-mails that were referenced in a state lawsuit brought against Putnam by a note holder called Loreley. It also makes reference to some e-mails that were referred to in an administrative complaint that was filed in Massachusetts by the Massachusetts Securities Division. And, parenthetically, with respect to the Loreley state court lawsuit, the second amended complaint alleges that Putnam and the other defendants settled that lawsuit. That is factually incorrect. Justice Schweitzer dismissed the Loreley complaint against Putnam for

failure to plead a claim. And the plaintiff in that action filed a stipulation of discontinuance stopping the action. There was no settlement by Putnam. There was no payment of money. There was a dismissal decision issued by Justice Schweitzer, and a stipulation of discontinuance filed by the plaintiff. Putnam paid no money, settled nothing.

So conscious misbehavior. I put in front of your Honor some selected exhibits. And I'm, again, I'm mindful of the hour. I just want to go through a couple because I would submit that these exhibits, they don't show that Putnam ever honored any suggestion by Magnetar to remove a security from the collateral pool and put something else in its stead. Here's what they show. And, your Honor, let me ask you, invite the Court to turn to tab two, exhibit 11 of the Orr affidavit. I've highlighted some language, your Honor. But this is one of the exhibits used to suggest that Putnam engaged in conscious misbehavior. And I've highlighted the language, your Honor. At the bottom of the first page there is an e-mail from a gentleman by the name of James Prusko of Magnetar to Carl Bell of Putnam. And Prusko writes to Bell of Putnam, would love your list of best short candidates. Very hard to get off sizeable CDO, CDS trades unless they are done against a deal, but our gig is really more macro anyway, not a securities selection play. So Prusko to Bell is saying, your Honor, you know, we're taking some short positions, but we're not

necessarily shorting specific collateral in this deal or anything like that. And that e-mail followed what I think is a very telling e-mail from Carl Bell, July 7th, 2006, where Bell writes to Prusko, I knew you planned to use mez ABS CDOs as part of your hedge, but I am not sure why you would hedge with the deals that we go long in Pyxis. We, Putnam, are going to pick the deals that have the best fundamental value. We, of course, would pick different deals as the best short candidates in terms of being a hedge against sub prime issues.

FGIC's theory is that this is a communication between two coconspirators in a billion dollar fraud. And yet at a time when neither side presumably has any reason to think that anyone will be looking over their shoulder, that has any reason to think that this e-mail is going to be the subject of a motion to dismiss in federal court, Bell of Putnam writes, we are going to pick the deals that have the best fundamental value. We would pick different deals as the best short candidates in terms of being a hedge against sub prime issues.

Now, is that evidence of the deliberate illegal conduct? I submit it's evidence of the exact opposite. Tab three, your Honor, is of similar, of a similar ilk. Again, if you look at page three of exhibit 12 behind tab three, you have an e-mail from Carl Bell to persons at Calyon, and a gentleman by the name of Mike Henriques who is with Deutsche Bank, one of the other equity holders, in which he writes -- I'm on page

three -- quote, we, Putnam, are doing preliminary work across a range of deals, and when this benchmarking is finished, we will be able to pursue a couple of synthetic trades. Again, Putnam, we're doing our own work, we're doing our own benchmarking analysis. Prusko responds, we are going to source the CDO exposure synthetically. We will buy CDOs CDS on names of your choosing at mid market. On names of your choosing. Again, is Magnetar being the master puppeteer or is Magnetar buying -- taking the short position on CDS based on securities selected by Putnam?

Then Magnetar goes on and says, any recent mez ABS deal is fine. Again, directed the selection of collateral basically saying, Putnam, whatever you provide us would be fine, we'll take the short position; I can send you a list of what's on our other deals if it's helpful. Typical names that we see a lot in other deals are the following, many others of similar ilk.

Again, at a time when no one has any reason to believe that anyone is looking over their shoulders, FGIC's theory is this is an alleged communication between alleged coconspirators, and yet Magnetar is saying we'll buy CDO CDS on names of your choosing.

It was no surprise to FGIC or any other entity that had an investment interest in this CDO that there would be a sophisticated financial institution taking the short side of

the CDS trades in the collateral pool. By definition, for any credit default swap you have an entity that's short, you have an entity that's long. Any investor that's long knows there's someone else taking a short position with respect to the credit default swap. Those are the e-mails, your Honor, involving Putnam.

There are other e-mails that may have been referred to in the second amended complaint, two of which I want to draw your attention to or invite your attention to. Behind tab four there's an e-mail between Calyon and James Prusko of Magnetar and Mike Henriques of Deutsche Bank, in which those three entities talk about, on page three, executing an agreement giving Deutsche Bank and Magnetar veto power 24 -- the usual 24 hours to object to any proposed asset that goes in the collateral pool. They talk about the usual 24 hours. Now, Deutsche Bank is one of the parties here on this e-mail exchange. Deutsche Bank is not a party to this lawsuit. Deutsche Bank is not alleged to have a short interest in this deal. Deutsche Bank was one of the equity holders along with Magnetar. As the equity holder, under certain scenarios they take the first loss. The usual 24 hours, I would submit, is consistent with an interpretation that the equity holders want to know what collateral is going into the collateral pool. What's significant, however, is Putnam is not on this e-mail. There's no suggestion that Putnam was a party to this

transaction, knew anything about it. I don't think there's anything wrong with it on its face. But Putnam's not even alleged to have been party to this transaction.

So, your Honor, I would submit then that not only is there no well pleaded allegation of loss causation, there is no well pleaded allegation of scienter.

Two other very quick points, your Honor. One is, I would invite the Court to look at Judge Sullivan's recent decision in Loreley versus Wells Fargo. That's another complaint that was brought against collateral managers, two collateral managers with respect to so-called Magnetar CDOs. Judge Sullivan dismissed the fraud base claims with prejudice finding, among other things, that failure to plead scienter, a failure to plead intentional misstatements. And he noted, just as is the case here, that the fact that Magnetar held a short interest does not give rise to a fraud. The fact that collateral, the collateral managers talk to the equity holders with respect to the selection of collateral does not suggest any impropriety. And the fact that the collateral managers spoke to Magnetar in order to curry favor with Magnetar, again is not something that gives rise to an intent to defraud.

So lastly, your Honor, let me address the negligence and negligent misrepresentation claims. Your Honor held in your September decision, correctly we believe, of course, that there was not an adequate allegation of a special relationship

between Putnam and FGIC. And, again, I don't believe there would have been a basis for such an allegation if FGIC was a note holder, but FGIC's not even a note holder. They issued a guaranty in support of a credit default swap entered into by a subsidiary with Calyon.

There are two New York State cases that I believe are directly relevant here, the M&T Bank case in the Fourth Department, and the HSH case versus UBS in the First Department. Both make clear that there is not such a special relationship under New York law where the collateral manager -- between the collateral manager and a note holder; whereas here, the offering memoranda contained express disclaimers saying there was no special relationship, there was no fiduciary duty, and that the note holders and other prospective investors were to do their own analysis prior to making an investment.

FGIC is relying on the Second Circuit decision in Bayerische. Your Honor I believe correctly distinguished Bayerische. There is one -- the issue in Bayerische was one of relationship between the collateral manager and note holders. FGIC is not a note holder. And, two, the Second Circuit made no mention of the fact that the offering memoranda, like the offering memoranda here, contained express disclaimers that there was no special relationship between the collateral manager and anyone else.

Nor, in contrast to Bayerische, under the collateral

management agreement here is there I believe any basis to argue, and FGIC in fact does not argue, that FGIC was a third party beneficiary under the collateral management agreement.

For all those reasons, I believe Bayerische is not applicable, and the appropriate pertinent authority is the HSH case and the M&T Bank case.

If your Honor has no questions, I'll sit down. Thank you.

THE COURT: Thank you.

MR. ARENA: Thank you.

MR. BALDWIN: Good afternoon, your Honor, Sean Baldwin for FGIC. I'd like to address each of Putnam's arguments in turn.

First, FGIC must plead loss causation; second, that FGIC has not met the Rule Eight notice pleading standard for loss causation; third, that FGIC has not adequately alleged scienter; and, lastly, that FGIC hasn't adequately alleged the special relationship necessary for the negligence by its claims in the second amended complaint.

But to begin with, I'd like to note that Putnam seems to have dropped its argument made in its opening brief that FGIC has failed to plead an actionable misrepresentation. There can be no real dispute that the second amended complaint more than adequately alleges that Putnam represented that it would select the Pyxis collateral independently and in good

faith in the interests of law and business and that Putnam did not in fact do that, but rather allowed Magnetar to control collateral selection even though Magnetar was a net short investor whose interests were directly adverse to those of long investors and FGIC.

The second amended complaint contains a wealth of particularized factual support for this allegation, far more than is required of the pleading stage, and sufficient for the summary judgment stage I would respectfully submit.

Nor can there be any really dispute that if FGIC had known that the Pyxis collateral was being selected by a net short investor, it would not have issued the Pyxis guaranty, and, thus, FGIC would have suffered no losses whatsoever when Pyxis defaulted. This ought to go without saying. No insurer would provide $900 million of insurance on a deal that it knew was being built to fail.

Nevertheless, Putnam argues that under the general common law of fraud, FGIC must plead not only that it would not have issued the Pyxis guaranty absent Putnam's fraud, but also that its losses were proximately caused by the facts that Putnam misrepresented, Magnetar's control and its adverse selection of Pyxis collateral.

The Court found that loss causation is required under general common law rules even where rescission or recissory damages are sought, and I will not attempt to reargue this

point today.

But what I will argue is that the general common law rule does not apply here because FGIC is a financial guaranty insurer governed by New York insurance law, and its claim is that it was induced to issue an insurance policy by material misrepresentations.

Putnam concedes that the First Department held in MBIA v. Countrywide that under Section 3105 of New York insurance law, a claim by an insurer that it was induced to issue an insurance policy by a material misrepresentation does not require proof of loss causation. That was the specific holding in that decision. The First Department held that under Section 3105 MBIA could recover claims paid pursuant to its insurance policies issued on RMBS sponsored by Countrywide without resort to rescission and without proof of loss causation.

And contrary to Putnam's argument in its briefs, the First Department's decision is not new or unprecedented. It follows a long line of authority, including decisions of the New York Court of Appeals, some of which are cited in the lower court decision by Justice Branston, and some of which predate Section 3105, that hold that an insurer need not prove loss causation to make out a claim for material misrepresentation in the inducement of an insurance contract.

So these cases dispose of Putnam's argument made in its brief that under the First Department's reading in MBIA,

Section 3105 implicitly abrogates common law. As these cases show, the First Department's reading in Section 3105 itself simply apply preexisting common law.

In the seminal case of Gear V. Union Mutual Life Insurance Company, which is cited in justice Branston's decision, it's at 273 NY 261, a 1937 case, it predated Section 3105 and even its predecessor Section 1149 of New York insurance law. An applicant for life insurance misrepresented that he had not received hospital treatment within the past five years, and then died of carbon monoxide poisoning, an unrelated event. There was no suggestion that the cause of death was related to the conditions for which he received hospital treatment. Nevertheless, the Court of Appeals held, quote, that the erroneous statement on the application deprived the insurer of its freedom of choice to decide which risks it would insure, and that was sufficient without more for the insurer to deny coverage under the insured's policies. That's at 270 of the decision.

Now Putnam concedes that Section 3105 applies to misrepresentations made by all or by the authority of the insured or the applicant for insurance. And it also concedes that Calyon was both the insured and the applicant under the Pyxis guaranty.

But Putnam argues that FGIC's misrepresentations were not made by the authority of Calyon, because Putnam wasn't

technically Calyon's agent. Putnam cites to no case holding that a misrepresentation must be made by an agent to be made by the authority of the applicant or the insured. It cites instead to a case or two that where the misrepresentations were made by an intermediary between the applicant and the insurer who communicated with the insurer quite separately from the applicant. And in those cases, in that context there's understandably doubt about whether the misrepresentations were made by the authority of the applicant, unless there's an agency relationship between the insurer and the -- I'm sorry -- between the applicant and the intermediary.

Those cases held that an agency relationship was sufficient to establish that the misrepresentations were made by the authority of the applicant, but they did not hold, and Putnam cannot find a single case that holds, that such a relationship is necessary to show that misrepresentations were made by the authority of the insured or the applicant.

And in this case there is no need for any such relationship to establish this fact. Because here there is no doubt that the misrepresentations were made by the authority of Calyon. This is because Calyon included Putnam's misrepresentations in its offering materials in order to induce FGIC to issue the Pyxis guaranty. Obviously, Calyon authorized the content of its own offering materials. So here there is no need to show that Putnam was acting as Calyon's agent in making

the misrepresentations. They were clearly made to FGIC by the authority of Calyon because they were made to FGIC by Calyon. They were transmitted to -- they were made by Putnam, but transmitted to FGIC by Calyon. And that's undisputed.

Next, Putnam argues that MBIA is distinguishable because, and I'll quote this because this is a very significant mistake. In their reply at page two, note three, they say, quote, MBIA involved claims for recovery of damages against the very counter party to the insurance contract who had received payments under the policy. That is wrong. Countrywide was not the counter party to the policies in MBIA, and it did not receive payments under the policies. The insured entities were the RMBS trusts, and those trusts received payments under the policies. Countrywide's only relationship to the policies was that it applied to MBIA to issue the policies. To that end, Countrywide entered into agreements for each RMBS with MBIA, pursuant to which MBIA agreed to issue the policies, but they were not the insurance contracts subject to Section 3105 under which MBIA paid claims. Those contracts were the policies issued by MBIA to the trust. So Countrywide was in a materially identical position to Putnam. It made the misrepresentations that induced the insurer to issue insurance policies, but it was neither the counter party to the policies, nor did it receive any payments under the policies. Countrywide's motive for making those misrepresentations, like

Putnam's, was simply to ensure that the transactions closed because like Putnam, Countrywide could only benefit if the transactions closed.

Despite all that, the First Department expressly held that MBIA could recover claims paid pursuant to its policies from Countrywide without resort to rescission and without proof of loss causation. If MBIA could recover its losses under its policies against Countrywide without proof of loss causation, FGIC should be able to do likewise against Putnam.

Now last, in a truly last ditch argument, Putnam argues that the Court can just ignore MBIA because it was issued by the First Department, not by the highest court in the state, the Court of Appeals. And that's also wrong. MBIA is a decision of a New York court applying New York law that has not been overruled and is not subject to appeal. It is axiomatic that a federal court apply New York law, should be governed by such a decision. That, for instance, is the holding in Travelers Insurance Co. V. 633 Third Associates, 14 F.3d at 119.

The case that Putnam sites In Re: MTBE is distinguishable. That case involved a situation where the state law was "uncertain" or "ambiguous" because an intermediary Appellate Court and a trial court disagreed in their interpretation of a recently enacted statute.

Here, the First Department, Justice Branston agreed

entirely that loss causation was not required under a very well established statute, New York insurance law Section 3105, and they applied a line of authority to reach that conclusion that included Gear and other decisions of the Court of Appeals that hold unequivocally that an insurer need not prove loss causation to make out a claim for material misrepresentation in the inducement of a insurance contract.

But in any case, your Honor, the second amended complaint adequately alleges loss causation under any standard, whether the standard is 9(b) or 8(a). But I'd like to begin by pointing out that the standard is 8(a). The standard, as your Honor has repeatedly held in fraud cases, including in securities fraud cases, has held that loss causation, allegations of loss causation are not subject to the heightened pleading standard of Rule 9(b), but must merely satisfy the 8(a) notice pleading standard, and under which, as your Honor has said, it is sufficient to provide "a short and plain statement that provides defendants with some indication of the loss and the causal connection that the plaintiff has in mind." That's your Honor's Freudenberg decision from 2010, the same year as the Cohen v. Stevanovich case that Mr. Arena referred to. That's your Honor's decision In Re: Bear Stearns, same year. And as your Honor also held in In Re: Bear Stearns, the party alleging loss causation need not rule out all competing theories as to the cause of its losses.

Similarly, in Dexia, a case that we cite, a 2013 case, this Court held -- not your Honor -- but this Court held that Lentell, the case primarily relied on by Putnam, does not place upon plaintiffs the heavy burden of pleading facts sufficient to exclude other non-fraud explanations. In fact Lentell expressly held that a number of things that I'd like to quote; one, loss causation is a fact-based inquiry. That's at 174; that if the loss was caused by an intervening event like a general fall in the price of internet stocks, the chain of causation is a matter of proof at a trial and not to be decided on a rule 12(b)(6) motion to dismiss. That's also at 174. And finally, it held, all reasonable inferences are drawn in the plaintiff's favor on a motion to dismiss. And that's at 174, 175.

Now, Lentell also held, as Putnam points out, that the occurrence of a market-wide phenomenon, quote, decreases the prospect that a plaintiff's loss was caused by the alleged fraud. But it went on to make clear that that did not require dismissal of the complaint as long as the complaint alleged facts sufficient to, quote, support an inference that the plaintiff would have been spared all or an ascertainable portion of its loss absent the fraud. That's at 175.

Now I note that Lentell says ascertainable, not ascertained. What Putnam is insisting is that FGIC must prove at the pleading stage exactly how much of its losses were

caused by Magnetar's adverse selection. That is not the standard FGIC must make. All FGIC must show at this stage is facts supporting an inference that some ascertainable portion of its losses were caused by the misrepresented facts, namely, Magnetar's adverse selection.

If FGIC can do this -- if FGIC has done this, as I submit it has in the second amended complaint, the Court should permit it to proceed to establish its case through discovery even where it suspects the intervening market wide phenomenon will ultimately prove to be the major or sole cause of the plaintiff's losses. Again, that's your Honor's holding in In Re: Bear Stearns quoting In Re: Fannie Mae at 507. Although it may be likely that a significant portion, if not all of plaintiff's losses were actually the result of the housing market downturn, and not these alleged misstatements, at this stage of pleading the Court need not make a final determination as to what losses occurred and what actually caused them, and need only find that plaintiff's allegations are plausible.

Now, the second amended complaint more than meets this standard. It alleges facts supporting an inference that the assets that were adversely selected for Pyxis by Magnetar defaulted both more quickly and to a greater extent than the assets Putnam would have selected had it acted independently. And, of course, at this stage without discovery FGIC cannot provide a complete list of the assets that Magnetar selected

for Pyxis, nor can it list exactly which assets Putnam would have selected for Pyxis had it acted independently. That's the nature of a fraud case. Prior to discovery, these facts are known only to the defendant.

But even without discovery, FGIC has actual managed to allege facts from which a far more than plausible inference can be drawn that it will be able to establish that some ascertainable portion of its loss was attributable to Magnetar's adverse selection which was concealed by Putnam.

First, by the end of 2008, 96 percent of Magnetar's 2006 vintage CDOs -- Pyxis was 2006 vintage -- had defaulted. Only 40 percent of non-Magnetar mezzanine CDOs from that vintage had defaulted. Putnam said, well, what's a mezzanine CDO? It could be anything from -- anything that's got a mezzanine tranche of securities in it. As Putnam well knows, everyone used the term mezzanine to mean sub prime. If that's all we need to do to change that to make to adequately allege loss causation we'll say sub prime, your Honor, because that's exactly what we're referring to, and everyone in the industry understood that. If Putnam wants to dispute that as a question of fact, it cannot be resolved on this motion to dismiss, but it will be resolved in our favor.

By 2010, so as of 2008, by the end of 2008 when Pyxis defaulted, we're talking 96 percent of Magnetar's CDOs from 2006, and only 40 percent, less than half of non-Magnetar

mezzanine sub prime CDOs defaulted. By 2010, all Magnetar CDOs had defaulted from that vintage, but only 63 percent of non-Magnetar mezzanine 2006 CDOs. And according to the most recent publicly available data, still only 30 -- sorry -- only 70 percent of non-Magnetar 2006 mezzanine CDOs have defaulted. And if they've got this far, your Honor, they're not likely -- there are not likely to be many more of them defaulting at this point. In other words, Magnetar's CDOs, including Pyxis, defaulted both more quickly than comparable CDOs and to a greater extent than comparable CDOs. And both of these are critical points.

The first, that Magnetar's CDOs defaulted more quickly, is sufficient in itself to establish loss causation. If FGIC suffered losses more quickly because of adverse, Magnetar's adverse selection, if it was required -- if it was liable under its $900 million Pyxis guaranty more quickly as a result of Magnetar's adverse selection, then it was deprived of the use of potentially $900 million for a period that it would not have been deprived of it had Putnam selected the collateral independently. That loss, in itself, is ascertainable and substantial.

But FGIC has gone further than that and has alleged that almost 30 percent, as I say, of non-Magnetar CDOs never defaulted at all. And if the assets that Putnam had selected for Pyxis or, sorry, if the assets that Putnam would have

selected acting independently were the assets that backed the non-defaulted CDOs, then Pyxis would not have defaulted either. But there's no way for us to know, without discovery, which assets Magnetar selected or which assets Putnam would have selected acting independently.

Putnam also said it would include $145 million of prime RMBS in the Pyxis portfolio. That was in the target portfolio that it had provided to FGIC in August of 2006.

Because Magnetar controlled collateral selection, Putnam never put a single prime RMBS into Pyxis. It dropped it completely and included $145 million of sub prime RMBS instead.

On its face, $145 million of sub prime RMBS is far more likely to default than 145 million of prime. That's what prime versus sub prime means.

Putnam says, well, this only affected 10 percent of the collateral. But it's only one of the types of collateral that FGIC has identified as having been put into Pyxis as a result of Magnetar's adverse selection.

FGIC has also identified another hundred -- well, we don't know if there are another hundred because we don't have the -- we don't have the full set of Magnetar's selected assets. But FGIC has identified $167 million of assets that were definitely selected by Magnetar. In its brief, not today, but in its brief Putnam says, well, FGIC hasn't proved these were selected by Magnetar. No, we haven't proved it, your

Honor, because we don't have to prove it here. We're alleging it. But even at this pleading stage, we have provided substantial evidence supporting our allegation that $167 million of assets were selected by Magnetar. And these assets, we provided -- we've given you the cites to the paragraph numbers in the complaint -- these assets defaulted significantly more quickly than the other assets for which we do not know one way or the other, whether they were selected by Magnetar. Putnam says, well, it's only .35 of a month on -- sorry -- of a year on average difference.

First of all, we don't know if that's the actual difference between all actually Magnetar selected assets and all non-Magnetar selected assets, because we don't know without discovery which assets were selected by Magnetar. And we don't know what Putnam would have selected otherwise.

But what we can say for sure is that the ones that Magnetar definitely selected, defaulted on average .35 of a year faster than the non-Magnetar or the non-known Magnetar selected. That is not an insignificant number, an insignificantly length of time for a $900 million investment. That $900 million that Pyxis was -- sorry -- FGIC was deprived of the use of the .35 of a year is an ascertainable loss for FGIC regardless of anything else that we may be able to prove. And as I say, if we can get discovery, find out what Magnetar actually selected and what Putnam would have selected if it was

acting independently -- if it was doing what Mr. Arena referred to in tab two of his exhibits and selecting the assets with the best fundamental value, we have no idea what the difference would have been. It could have been far more. And it could have been some of the assets would never have defaulted, enough of them that Pyxis would -- sorry -- FGIC would never have incurred any liability.

Finally, FGIC has identified $95 million of assets that defaulted in 2007 or early 2008 before Bear Stearns collects. Putnam says, well, so what? We don't know if Bear Stearns was the beginning of the financial crisis. True, it's a question of fact when the financial crisis began. But we do know that a large amount, 60 million defaulted in -- 66 million defaulted in 2007 before anyone could claim there was a financial crisis. Somehow these assets defaulted before there was any market wide phenomenon affecting housing prices. Those assets had to have defaulted as a direct result of their inherent defects, and those were assets selected by Magnetar. Our allegation is Putnam would not have selected those assets, absent Magnetar's control.

Finally, Putnam argues that FGIC has only alleged adverse selection of a portion of the collateral, and it may not be sufficient, that portion may not be sufficient to have reached the threshold at which FGIC's guaranty kicked in. That was $600 million of the 1.5 billion. It was only the top 900

that FGIC insured. But we do not know how many assets Magnetar selected. So we don't know whether that threshold was reached and we can not know, and Putnam cannot know. It's a question of fact whether that threshold was reached. So I submit that we've adequately alleged loss causation, even though we don't need to, your Honor.

Putnam spent most of its presentation today, Mr. Arena spent most of it talking not about loss causation, but about scienter. We have alleged facts strongly supporting the inference both that Putnam had a motive to commit fraud and that it engaged in conscious wrongdoing.

Let me begin with motive. Putnam does not appear to dispute that motive can be alleged generally. That's what Rule 9(b) says, it can be alleged generally.

But the second amended complaint does much more than allege it generally. The second amended complaint alleges that Putnam was paid fees for its work on Pyxis that were twice as large as those paid to the collateral manager on a normal CDO at that time. Putnam says, well, the rate on a normal CDO was 40 basis points and we only got 20 basis points. But that ignores that Pyxis was four times as large as a normal CDO. Documents that we have cited to, we've quoted in the complaint, show that a normal CDO was something like $400 million at the time, and Pyxis was 1.5 billion. So half of four times as much is twice as much.

Now, Putnam then says, but their fees were subordinated 5 percent of their -- sorry -- five of their 20 basis points were subordinated, and they would only get those if Pyxis actually succeeded. It's just not true. They keep getting paid fees long after Pyxis began to default, after the collateral began to default. As we cite in the amended complaint, in the second amended complaint, paragraphs 48 and 49, Putnam got a lot of fees after everyone else had stopped being paid, apart from Magnetar.

The senior note holders got nothing after that date, the collateral began to default, but Putnam kept getting paid. It kept getting paid its fixed and its subordinated fee. And it kept getting paid its fixed fee for years after Pyxis itself defaulted.

So Putnam -- actually take a step back -- Putnam was getting paid for years after the entire CDO had defaulted. It didn't get as much, but it got something. So Putnam's argument that these fees were not guarantied or that it depended on the performance of the CDO are simply false.

And not only that, but one of the documents that we cited to your Honor, which Putnam drew attention to, it's Exhibit six of their, or tab six of their exhibit. In that document, Michael Henriques of Deutsche Bank, who left Deutsche Bank after Pyxis closed and went to join Jim Prusko at Magnetar, said, referring to all Magnetar's CDOs, including

Pyxis, that the collateral managers fees on those CDOs were virtually assured -- that's his quote -- by Magnetar's significant control of the CDOs. That's in fact what happened. Putnam says it wouldn't have been worth the reputational risk to its institution to have engaged in this Pyxis fraud that it's alleged to have engaged in. But whether it's worth it or not is a question of fact. And Putnam ignores that the individuals who actually worked on Pyxis, most notably Carl Bell, and who stood to gain most of the fees from Pyxis, may well have had very different motives from the institution as a whole. Putnam says it would have made more if Pyxis had succeeded. But it would have made nothing at all if it hadn't cooperated with Magnetar. Because as we allege in the complaint, again with evidence to back it up, Putnam would not have been selected to work as the collateral manager on either Pyxis or Pyxis 2007-1 if it hadn't cooperated with Magnetar, and its selected assets that as the tab that Mr. Arena referred to were fundamentally, you know, had fundamental value, whatever the term was. So Putnam would have made nothing if it had not allowed Magnetar to adversely select the collateral.

Now, separately, the second amended complaint alleges facts that strongly support an inference of conscious wrongdoing, and that is sufficient in itself to establish scienter. The second amended complaint alleges that Putnam was complicit in the, quote, veto powers by which Magnetar was

granted veto powers over the collateral for Pyxis. And if I can draw your attention again to tab four of Putnam's exhibit, your Honor, that is the veto powers cited, or it's the e-mail referring to the veto powers cited. That e-mail states in the language that Putnam has highlighted, Calyon hereby agrees -- this is on the fourth page of it, I think -- Calyon hereby agrees that each of Deutsche Bank and Magnetar for so long as the respective equity purchase letter has not been terminated, shall have the right to object to the proposed acquisition of any asset pursuant to the warehouse agreement within 24 hours after notification thereof has been sent to Deutsche Bank and Magnetar by Calyon or the investment advisor. The investment advisor is Putnam -- provided that one of Calyon or the investment advisor will promptly provide such notification.

Putnam was required under this agreement to provide notice to Magnetar of assets it was proposing to include in Pyxis, and Magnetar had a right to veto those assets.

Now Magnetar -- sorry -- Putnam's counsel says there is no evidence that this thing was actually executed. It's true we don't have an executed copy of it. We haven't had discovery yet, your Honor. But what we do know, even without discovery, is that it is absolutely clear that the arrangement envisaged in that letter was in fact implemented. The second amended complaint alleges dozens of communications between Putnam and Magnetar in which Magnetar made clear which assets

it wanted included in Pyxis, and that it wanted to short those assets, and in which Putnam agreed, Carl Bell, agreed to select these assets and to help Magnetar short them.

Putnam disputes the import of some of these communications. If you look at tab three Putnam says -- it highlights a piece of this which talks about Magnetar says, we will buy CDO CDS or names of your choosing at mid market, and any recent mez ABS deal is fine, I can send you a list of what's in our other deals if that's helpful. But then he goes on to say typical names that we see in other deals a lot, plus our other deals that are priced, and he gives a list. Two of those, by the, way are Magnetar CDOs.

What Putnam ignores is the subsequent e-mails in this chain. In the next e-mail Mr. Prusko from Magnetar writes to Alex Racada from Calyon, who shortly after this transaction closed, went off to Nomura to do very similar thing with the Nomura transaction and he ended up being barred from the securities industry this year or last year as a result of his conduct at Nomura. And Mr. Prusko says to Racada, please stay on top of Putnam's CDO situation, get a little nervous when I hear about Bill piddling disk access to them, although not too worried about Putnam doing anything rash. In other words, he's reasonably confident Putnam will do what they're told. And in the very next e-mail he says -- sorry -- Racada says, sure I'll keep an eye on them. And Prusko then says, don't like that

they are buying CDOs without us knowing about, at least I don't think I knew about it, I'll check in with Carl, just saw him, thought we were on the same page with us buying the CDS.

This is not a man who thinks that Putnam is acting independently. This is a man who thinks he's got him under his thumb. At an absolute minimum it's a question of fact.

Tab two that Putnam refers to in this exhibit. If you look at the date on that document, your Honor, that's July 7, 2006. That's when Putnam's just getting into the process of ramping up the collateral. They are just starting to talk about it with Magnetar. And at that point Carl Bell is saying, we'll select assets with the best fundamental value.

That changed. By August, Carl Bell was under Magnetar's thumb and doing what he's told. And let's not forget Carl Bell and Prusko's relationship. Bell used to work for Prusko when Prusko was at Putnam. That's why Bell was selected. That's why Putnam was selected, to manage Pyxis.

The second amended complaint also alleges communications in which Putnam and Calyon sought to conceal Magnetar's role from investors. And it alleges in another document that Putnam inexplicably shows your Honor, that after Pyxis closed, Michael Henriques of Deutsche Bank discussed the nature of Magnetar's CDOs with Magnetar and Calyon. This is tab five of their exhibits. If you look at tab five, I have highlighted the language that they like, and that ignored the

part that actually matters from our point of view. At the end of the e-mail, which talks about programs -- they're talking here about a subsequent deal, a deal NIB was being hired to act as collateral manager on. And they're saying that they may want to fire or at least have the opportunity, option to fire NIB if they feel they're not doing a good job. What do they mean by that? They say, perhaps NIB would rather go back to the regular style CDOs with $400 million mixed deals scrapping for cash bonds, spending nine months on ramp up and three months marketing to get 40 basis points running on a $400 million balance. That's why Putnam wanted to do this deal so it didn't have to do all of that.

Then they go on to say, these deals are not CDOs, but they are structured separate accounts. They are designed for the benefit of the equity investor. And he concludes: I think Putnam got it, NIB doesn't. He specifically distinguishes Putnam's equity on Pyxis from NIB's recalcitrance.

And, finally, proving Putnam's complicity and conscious wrongdoing, Putnam was hired for Pyxis 2007-1, which closed after Pyxis -- sorry was ramped rammed after Pyxis 2006-1. That would not have happened, as we allege, had Putnam not cooperated with Magnetar on Pyxis, had Putnam done what NIB was threatening to do on Orion two. Those facts, your Honor, I submit, are more than sufficient to satisfy the scienter pleading requirements. Loreley v. Wells Fargo, Justice

Sullivan's decision -- Judge Sullivan's decision is completely irrelevant. We are not disagreeing with Judge Sullivan's decision, but it was based on a totally different set of facts. Those facts involved I think three e-mails. Nothing like the e-mails that we've got, nothing like the incriminating communications between the collateral manager and Magnetar.

Lastly, your Honor, the special relationship sufficient to support a negligence base claim. I respectfully submit -- I recognize your Honor's decision, but I ask you to consider three points which, in our view, make this case indistinguishable from Bayerische, the Second Circuit's case, which held that a special relationship was adequately alleged.

First of all, Putnam argues, and the Court previously held, that this case is distinguishable from Bayerische because in Bayerische, the investor was an express third-party beneficiary under the CDO transaction documents. I submit that that is irrelevant.

The Court in Bayerische expressly held that the portfolio managers duty of care arose not out of contract, but, quote, out of independent characteristics of the relationship between Bayerische and Aladdin, which was the portfolio manager. That's at page 45.

Second, Putnam argues, and the Court held that Bayerische was distinguishable because the investor in that case purchased securities issued by the CDO, while FGIC insured

a credit default swap. And I respectfully submit that that is a distinction without a difference. And that's what the Commodities Future Modernization Act made absolutely clear when it expressly provided that the federal securities laws apply equally to swaps referencing securities as to direct purchases of securities. Both types of investment are functionally or economically identical.

In fact, FGIC's investment in Pyxis was far more significant than the investors' investment in Bayerische. FGIC's guaranty insured payments on the $900 million super senior tranche of Pyxis. That was 60 percent of the total value of the CDO. That's why FGIC went to all the trouble it did, engaging in extensive e-mail conversation with Putnam by directly and through Calyon, and having conference calls about Pyxis, and even it going to Boston to have an in-person meeting with Putnam at its offices, to secure Putnam's assurances that it would select the Pyxis collateral independently and in good faith, and using its expertise and experience, and to find out what that expertise and experience consisted of, and what collateral selection technology and process Putnam would use, what guidelines. All of that only mattered because it believed, FGIC believed Putnam was selecting the collateral.

And as the complaint also alleges, FGIC's investment, unlike the Bayerische investor, was essential to Pyxis' closing and so it was essential to Putnam reaping the benefits it hoped

to reap from Pyxis. That's why Putnam made the representations it did on which FGIC chiefly relied in issuing the Pyxis guaranty.

And it's the combination of those factors, FGIC's known dependence on Putnam and Putnam's known dependence on FGIC, the mutual symbiotic relationship, that's what creates the special relationship here. Those facts are even more compelling, I submit, than the Bayerische facts given the much greater importance of FGIC to the transaction as a whole.

And lastly Putnam argues, and the Court's decision held, that the disclaimers in the offering memorandum advising investors not to rely on reps other than those in the offering memorandum and to rely on their own due diligence, bar a special relationship here. I'll begin by saying I think Mr. Arena may have misspoke. I think he said disclaimers didn't -- that the disclaimers here said there was no special relationship. They didn't say that. He's just inferring that. They didn't say anything of the sort, and that's not what they -- that's not the conclusions you draw from those disclaimers. As we show in our brief exactly, the same disclaimers were contained in the Bayerische offering materials, and they did not preclude the Second Circuit from holding the special relationship existed. Putnam tries to wish those disclaimers away. But those disclaimers should not have made any difference. Not only did they not make a difference,

but there was no reason for them to. Because Putnam's misrepresentations as to its role in collateral selection were made as well as orally and through e-mails and phone calls, in person meetings, in the very offering memorandum on which the disclaimers stated that FGIC should rely, and because FGIC did precisely the due diligence that the offering memorandum said it should do. It went to Boston. It talked to Putnam. It examined extensively Putnam's expertise, experience, collateral selection process, and it obtained extensive representations from Putnam as to that process, as to its experience and expertise to ensure that its $900 million investment would be in safe hands.

Putnam knew FGIC was relying on it and actively sought to induce FGIC to rely on it to ensure that the transaction closed and it could reap all the benefits it anticipated from the transaction, and that it did reap -- that's why a special relationship existed and why the second amended complaint adequately alleges negligence based claim. Thank you, your Honor.

MR. ARENA: Very very briefly, your Honor.

Your Honor, let me start with the argument about scienter and fees, then I'll circle back to loss causation and duty, and I'll even touch upon the absence of an allegation, the absence of a sufficient allegation of a material misrepresentation or omission.

Fees. FGIC's counsel argued that Putnam continued to receive fees well after, well after the deal defaulted. Well, I would invite the Court's attention to paragraph 48 of FGIC's second amended complaint. The argument was made, Putnam continued to receive subordinated incentive fees. Really? Their pleading. As of December 10, 2008, Putnam had received cumulative subordinated fees of 1,331,647 through two years after the deal closed. Here's how much in cumulative subordinate fees Putnam received through July of 2012, three and a half years later; the same exact amount. Had the deal not failed, Putnam would have continued to receive those fees through today. They stopped receiving those fees through December 2008. Their pleading, not ours.

Senior fees, the 15 basis points senior fees. These are based upon the collateral assets that are continuing to perform. Through December 10, 2008, two years after the deal fails, two years after the deal closes, total fees approximately 4.1 million. Again, if the deal doesn't fail, Putnam is getting 2.25 million a year. They get 4.1 through December 10, 2008. Through July 2012, they get a total of cumulatively 4.375. Those, yes, Putnam is continuing to get senior fees, but it's a drip from the faucet. It's not 2.25 million a year. Again, is that a motive to commit the fraud or a motive not to commit a fraud? I submit it's the latter, your Honor.

With respect to some of the e-mails that are referred to here I put in front of the Court. FGIC's best argument with respect to exhibit 12 behind tab three -- I'm sorry -- behind tab two where Mr. Bell of Putnam says, we are going to pick the deals that have the best fundamental value? Apparently, their argument is, well, that's early in the stage before you were corrupted. Apparently that's their best argument.

However, they ask the Court to draw negative inference from the fact there is a so-called veto agreement which would give Putnam -- I'm sorry -- which would give Magnetar and Deutsche Bank 24 hours in which to object to the selection of collateral assets. Strangely enough, that draft agreement, not alleged to have been executed, that draft agreement is from June, one month before Mr. Bell says in an e-mail to Mr. Prusko, we're only going to pick the assets with the best fundamental value.

Behind tab three there's the e-mail exchange. Prusko writes to Mike Henriques of Deutsche Bank -- this is Magnetar to Deutsche Bank, two equity holders -- don't like that they, Putnam, are buying CDOs without us knowing about it. That's the last e-mail in the chain.

It's their obligation, it's their burden to plead conscious misbehavior by Deutsche Bank. The best that they can do is to come up with e-mails like this which show that Putnam is acting independently.

With respect to their loss causation arguments, your Honor, I kept hearing from FGIC's counsel, we need discovery, discovery will show which assets Magnetar picked and which assets Putnam would have picked but for Magnetar's control. I submit it's their burden at the pleading stage, governed by 9(b), to have evidence. They brought an important claim, a fraud claim against Putnam, a well respected member of the corporate community charging Putnam with the participation of a billion dollar fraud. It's their burden. If they don't have the factual allegations now, the case ought to be dismissed with prejudice. This is their second amended complaint. They've already had two bites at the apple. They can't hang their hat on just give us discovery.

With respect to the $167 million in assets they suggest that they have evidence that Magnetar directed Putnam to select, where is it? Where is it? Their theory is Putnam was totally under Magnetar's control. Now we have sort of the fallback position; well, maybe some of the assets were directed to be selected by Magnetar, and had you not selected those and you selected something else the deal wouldn't have failed. It's highly speculative, your Honor.

With respect to whether they even need to prove loss causation. What I would say about that is your Honor got it right in your decision. The MBIA case which they suggest is on all fours with this case is not similar. Countrywide was the

applicant for the insurance. They were the applicant for insurance. Putnam was not an applicant for insurance. Putnam wasn't a party. They didn't ask for the guaranty. They didn't sign for the guaranty. They weren't a counterparty. They didn't negotiate it. Period, full stop. That's a meaningful distinction.

And then with respect to Bayerische, your Honor, they argue, well, in Bayerische the offering memorandum contained similar disclaimers and the Court in Bayerische didn't find that to be disqualifying as to whether there was a special relationship on the facts of that case between the collateral manager and the investor. There was no suggestion in the Bayerische opinion that the Court even focused on disclaimers in the offering memorandum.

FGIC's counsel are very enterprising. They rooted through the records. They found the offering memo for the deal that was subject to the Bayerische opinion, and they found the offering memo. There's no suggestion that was even argued as it is here that the disclaimer language foreclosed the existence of a special duty.

Does it, as a matter of law, foreclose the existence of a special duty? I would invite the Court's attention to the HSH case and the M&t bank case, both cases decided under New York lawsuit Fourth Department with respect to M&T, First Department with respect to the HSH case. Both seem to hold

squarely that existence of this disclaimer language, similar to the type of disclaimer language here, forecloses the existence of a special relationship.

If you think about it, your Honor, we have a situation where FGIC is saying, forget what's in the disclaimer language. If you talk to us, we can allege based on the fact that you talked to us that there is a special relationship. If every collateral manager was subject to having a potential duty foisted upon itself simply because it talked to a potential investor, they would never talk to any potential investors if the disclaimer language is meaningless and can be simply pleaded around.

Unless the Court has any questions, your Honor, I'll rest on the brief.

I will note one thing, which is Putnam has not abandoned its arguments which are set forth in our brief regarding the failure to plead an actionable mis-rep or omission. We cite the Wells Fargo case by Judge Sullivan which we think is clearly on all fours. The argument's made that that decision is completely irrelevant. Well, here's what was alleged by the Wells Fargo plaintiffs, if you'll indulge me just one minute.

One, they alleged that Magnetar held a short position in the CDOs at issue; two, that the collateral managers knowingly abdicated their responsibility to select collateral

assets to Magnetar; three, in order to curry favor with Magnetar, the collateral managers selected assets that would cause the CDO to fail; and, four, the Wells Fargo plaintiffs alleged that the collateral managers were accountable for allegedly false statements in the offering circulars, saying that the collateral managers would select and monitor the collateral in the CDOs at issue.

Those are precisely the allegations here, precisely the allegations here. To suggest that that case is, quote, completely irrelevant, close quote, doesn't pass the red face test.

And what did Judge Sullivan hold? He held that there was nothing improper -- his words -- improper about Magnetar hedging its exposure to the equity tranche, Magnetar wishing to be kept apprised of which assets were going into the CDO, Magnetar sourcing the short positions on the credit default swaps in the collateral pool.

That's exactly the same allegations here. Judge Sullivan held that there was not -- there was neither an actionable mis-rep or omission, nor was there an adequate allegation of scienter. Thank you, your Honor.

THE COURT: Thank you all very much. As you might anticipate, I'll reserve decision.

MR. ARENA: Thank you.

MR. BALDWIN: Thank you, your Honor.

(Adjourned)